

Internal Revenue Service

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Department of the Treasury
Washington, DC 20224

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Person To Contact:
, ID No.

Telephone Number:

Refer Reply To:
CC:PSI:B07
PLR-136787-06

Date:
August 07, 2007

Legend

Trust A =
Grantor =
Date 1 =
Date 2 =
Date 3 =
Date 4 =
Date 5 =
Spouse =
Court 1 =

Date 6 =

Dear :

This letter responds to your letter, dated July 19, 2006, and subsequent correspondence, submitted on behalf of Trust A, requesting rulings under §§ 61, 1001, 1015, 2207A, 2511, 2519 and 7520 of the Internal Revenue Code.

Grantor created a revocable trust on Date 1. The trust agreement was amended on Date 2, Date 3, and Date 4. The trust agreement became irrevocable on Grantor's death on Date 5.

Section 3.3.1 of the trust agreement, as amended, provides that if Spouse survives Grantor for five months, the trustees shall divide the trust into two separate shares: Trust A, and Trust B. Section 3.3.2 provides that Trust B shall be funded with (i) all assets that are excluded from Grantor's gross estate for federal estate tax purposes, (ii) all assets for which the federal estate tax marital deduction is not allowable in the Grantor's estate, and (iii) an amount that, when added to the value of all

interest in property included in the Grantor's federal taxable estate, will equal the largest taxable estate on which no federal estate tax is payable after deduction of the credits allowable to the Grantor's estate. Section 3.3.3 provides that the residue of Grantor's estate shall be allocated to Trust A.

Section 4.1 of the trust agreement governs the administration of Trust A. Section 4.1.2 provides that Spouse shall receive the net income from Trust A at least annually. Section 4.1.3 provides that the trustees may make discretionary distributions of principal to Spouse for her support, maintenance, and medical care. Section 4.1.4 provides that Spouse may disclaim her interest in Trust A, in whole or in part. Any disclaimed property shall be added to Trust B and distributed as if originally a part thereof. Section 4.1.5 provides that on Spouse's death, the trustees shall distribute any accrued or undistributed income to her estate and shall distribute the principal to the trustees of Trust B to be held, administered, and distributed as a part of Trust B. The executor of Grantor's estate elected to treat the Trust A assets as qualified terminable interest property (QTIP) under § 2056(b)(7).

Trust B provides for grantor's children and their descendants. Under the terms of the trust agreement, Trust B was divided into three subtrusts upon Grantor's death, one for the benefit of each of Grantor's children. Each child has a testamentary limited power of appointment over the Trust B subtrust assets held for his or her benefit.

Spouse wishes to disclaim her interest in Trust A. The trustees of Trust A have received a ruling from Court 1 that determined that the disclaimed property will be distributed as if originally a part of Trust B. Spouse represents that she will pay any gift taxes arising from her disclaimer of the income interest in Trust A. Spouse will exercise her right of recovery for gift tax relating to the transfer of the remainder interest pursuant to § 2207A(b).

Spouse represents that the current basis of the Trust A assets exceeds their fair market value.

Spouse has requested the following rulings: (1) Spouse's disclaimer, when effective, will constitute a completed net gift of the remainder interest in Trust A for federal gift tax purposes, provided Spouse exercises her right of recovery under § 2207A; (2) Spouse's disclaimer, when effective, will constitute a completed gift of Spouse's income interest in Trust A under § 2511 for federal gift tax purposes; (3) the disclaimed interests in Trust A will not be includable in Spouse's gross estate at her death for federal estate tax purposes; (4) the appropriate § 7520 annuity factor used to value the income and remainder interest is the standard § 7520 annuity factor; (5) Spouse will incur no income tax liability arising from the disclaimer; and (6) guidance on determining the transferees bases in the disclaimed property.

Rulings 1-3

Section 2044(a) provides that the value of the gross estate shall include the value of any property in which the decedent had a qualifying income interest for life. Section 2044(b) provides that § 2044(a) applies to any property if a deduction was allowed with respect to the transfer of such property to the decedent under § 2056(b)(7) and § 2519 did not apply with respect to a disposition by the decedent of part or all of such property.

Section 2056(b)(7) allows an estate tax marital deduction for qualified terminable interest property. Under § 2056(b)(7)(B)(i), the term “qualified terminable interest property” means property that passes from the decedent, in which the surviving spouse has a qualifying income interest for life, and to which the qualified terminable interest election under § 2056(b)(7)(B)(v) applies. Section 2056(b)(7)(B)(ii) provides that the surviving spouse has a qualifying income interest for life if the surviving spouse is entitled to all the income from the property, payable annually or at more frequent intervals, and no person has a power to appoint any part of the property to any person other than the surviving spouse during the surviving spouse’s life.

Section 2207A(b) provides that, if for any calendar year tax is paid under chapter 12 with respect to any person by reason of property treated as transferred by such person under § 2519, such person shall be entitled to recover from the person receiving the property the amount by which the total tax for the year under chapter 12 exceeds the total tax that would have been payable under the chapter for the year if the value of the property had not been taken into account for purposes of chapter 12.

Section 25.2207A-1(a) of the Gift Tax Regulations provides, in part, that if an individual is treated as transferring an interest in property by reason of § 2519, the individual is entitled to recover from the “person receiving the property” the amount of gift tax attributable to that property. The value of property to which this paragraph applies is the value of all interests in the property other than the qualifying income interest. The right of recovery arises at the time the federal gift tax is actually paid by the transferor subject to § 2519.

Section 25.2207A-1(e) provides that if the property is in a trust at the time of the transfer, the “person receiving the property” is the trustee, and any person who has received a distribution of the property prior to the expiration of the right of recovery if the property does not remain in trust.

Section 2501 imposes a tax on the transfer of property by gift by an individual. Under § 2502(c), the gift tax imposed under § 2501 is the liability of the donor.

Section 2511 provides that the tax imposed by § 2501 shall apply whether the transfer is in trust or otherwise, whether the gift is direct or indirect, and whether the property is real or personal, tangible or intangible.

Section 25.2511-1(c)(1) provides that the gift tax is a primary and personal liability of the donor, is an excise upon his act of making the transfer, is measured by the value of the property passing from the donor, and attaches regardless of the fact that the identity of the donee may not then be known or ascertainable.

Section 2519 provides that for gift tax purposes, any disposition by the surviving spouse of all or part of a qualifying income interest for life in any property for which a deduction was allowed under § 2056(b)(7) is treated as a transfer by the surviving spouse of all interests in the property other than the qualifying income interest. The transfer of the qualifying income interest is a transfer subject to gift tax under § 2511.

Section 25.2519-1(a) provides, in part, that if a donee spouse makes a disposition of all or part of a qualifying income interest for life in any property for which a deduction was allowed under § 2056(b)(7), the donee spouse is treated for purposes of chapters 11 and 12 of Subtitle B of the Code as transferring all interests in property other than the qualifying income interest. If the donee spouse makes a disposition of part of a qualifying income interest for life in trust corpus, the spouse is treated under § 2519 as making a transfer subject to chapters 11 and 12 of the entire trust other than the qualifying income interest for life. Therefore, the donee spouse is treated as making a gift under § 2519 of the entire trust less the qualifying income interest, and is treated for purposes of § 2036 as having transferred the entire trust corpus, including that portion of the trust corpus from which the retained income interest is payable. A transfer of all or a portion of the income interest of the spouse is a transfer by the spouse under § 2511.

Section 25.2519-1(c)(1) provides that the amount treated as a transfer under § 2519 upon a disposition of all or part of a qualifying income interest for life in qualified terminable interest property is equal to the fair market value of the entire property subject to the qualifying income interest, determined on the date of the disposition (including any accumulated income and not reduced by any amount excluded from total gifts under § 2503(b) with respect to the transfer creating the interest), less the value of the qualifying income interest in the property on the date of the disposition. The gift tax consequences of the disposition of the qualifying income interest are determined separately under § 25.2511-2.

Section 25.2519-1(c)(4) provides that the amount treated as a transfer under § 25.2519-1(c)(1) is further reduced by the amount of gift tax the donee spouse is entitled to recover under § 2207A(b). If the donee spouse is entitled to recover gift tax under § 2207A(b), the amount of the gift tax recoverable and the value of the remainder interest treated as transferred under § 2519 are determined by using the same

interrelated computation applicable for other transfers in which the transferee assumes the gift tax liability. The gift tax consequences of failing to exercise the right of recovery are determined separately under § 25.2207A-1(b).

Rev. Rul. 75-72, 1975-1 C.B. 310, holds that if, at the time of the transfer, a gift is made subject to a condition that the gift tax is to be paid by the donee or out of the transferred property, then the donor receives consideration for the transfer in the amount of the gift tax to be paid by the donee. Thus, under § 2512(b), the value of the gift is the fair market value of the property passing from the donor less the amount of the gift tax to be paid by the donee or from the property itself. Rev. Rul. 81-223, 1981-2 C.B. 189, holds that, in determining the amount of the gift tax liability that is to be subtracted from the value of the transferred property, the donor's available unified credit must be used to reduce the gift tax liability that the donee has assumed to the extent the unified credit is available.

The assets of Trust A qualify under § 2056(b)(7) and Grantor's estate elected to treat the assets as QTIP on Grantor's estate tax return. Spouse intends to disclaim her entire interest in Trust A. Accordingly, under § 2519, Spouse will be deemed to have made a transfer of all of Trust A's assets, other than her qualifying income interest. Spouse is treated as making a gift under § 2519 of the fair market value of Trust A, determined on the date of disposition (including any accumulated income and not reduced by any amount excluded from total gifts under § 2503(b) with respect to the transfer creating the interest) reduced by the value of Spouse's qualified income interest, and further reduced by the amount Spouse is entitled to recover under § 2207A(b). The amount of the gift tax recoverable and the value of the remainder interest treated as transferred under § 2519 are determined by using the same interrelated computation applicable for other transfers in which the transferee assumes the gift tax liability. The transfer of Spouse's income interest in Trust A resulting from the disclaimer is a transfer by Spouse under § 2511. The amount of the gift will be the value of Spouse's qualified income interest on the date of disposition. After Spouse disclaims her entire interest in Trust A, no portion of the Trust A assets that are deemed transferred under § 2519 will be included in Spouse's gross estate pursuant to § 2044(b).

Ruling 4

Section 25.2512-5(d)(1) provides that, with respect to actuarial valuations after April 30, 1999, except as otherwise provided in paragraph (b) and § 25.7520-3(b) (relating to exceptions to the use of prescribed tables under certain circumstances), if the valuation date for the gift is after April 30, 1999, the fair market value of annuities, life estates, terms of years, remainders, and reversions transferred after April 30, 1999, is the present value of such interests determined under § 25.2512-5(d)(2) and by use of the standard or special § 7520 actuarial factors.

Section 25.7520-3(b)(1)(i)(B) provides that an “ordinary income interest” is the right to receive the income from or the use of property during one or more measuring lives or for some other defined period. A standard § 7520 income factor for an ordinary income interest represents the present worth of the right to receive the use of \$1.00 for a defined period using the interest rate prescribed under § 7520 for the appropriate month.

Section 25.7520-3(b)(1)(i)(C) provides that an “ordinary remainder or reversionary interest” is the right to receive an interest in property at the end of one or more measuring lives or some other defined period. A standard § 7520 remainder factor for an ordinary remainder or reversionary interest represents the present worth of the right to receive \$1.00 at the end of a defined period, using the interest rate prescribed under § 7520 for the appropriate month.

Based upon the representations made and information submitted, a standard § 7520 income factor and a standard § 7520 remainder factor, respectively, should be used to determine the value of the disclaimed income interest and the value of the remainder interest.

Ruling 5

Section 61(a)(12) provides that gross income includes income from discharge of indebtedness.

Section 1001(a) provides that the gain from the sale or other disposition of property shall be the excess of the amount realized therefrom over the adjusted basis provided in § 1011 for determining gain, and the loss shall be the excess of the adjusted basis provided in § 1011 for determining loss over the amount realized.

The Supreme Court in Diedrich v. Commissioner, 457 U.S. 191, 199-200 (1982), held that in a net gift situation, where a donor makes a gift of property on condition that the donee pay the resulting gift taxes, the donor realizes taxable income to the extent that the gift taxes paid by the donee exceed the donor's adjusted basis in the property. A net gift transfer is treated as if the donor sells the property for less than fair market value. The sale price is the amount of the gift tax paid by the donee and the remaining value of the property is treated as a gift. The donor's gain is equal to the excess of the gift tax liability over the donor's adjusted basis in the property.

Spouse intends to recover the gift tax paid under § 2207A relating to the deemed transfer of Spouse's remainder interest in Trust A pursuant to § 2519. Based upon the information submitted and the representations made, Spouse's basis in the disclaimed property is equal to or greater than the gift tax recovered from Grantor's children. Accordingly, Spouse will not be liable for income tax as a result of the disclaimer.

Ruling 6

Section 1015(a) provides that with respect to property acquired by gift after December 31, 1920, the basis shall be the same as it would be in the hands of the donor or the last preceding owner by whom it was not acquired by gift, except that if such basis (adjusted for the period before the date of the gift as provided in § 1016) is greater than the fair market value of the property at the time of the gift, then for the purpose of determining loss the basis shall be such fair market value. If the facts necessary to determine the basis in the hands of the donor or the last preceding owner are unknown to the donee, the Secretary shall, if possible, obtain such facts from such donor or last preceding owner, or any other person cognizant thereof. If the Secretary finds it impossible to obtain such facts, the basis in the hands of the donor or last preceding owner shall be the fair market value of the property as found by the Secretary as of the date or approximate date at which, according to the best information that the Secretary is able to obtain, the property was acquired by the donor or last preceding owner.

Section 1015(b) provides that if property is acquired by a transfer in trust (other than a transfer in trust by a gift, bequest, or devise), the basis shall be the same as it would be in the hands of the grantor increased in the amount of gain or decreased in the amount of loss recognized to the grantor on such transfer.

Section 1015(d) provides that with respect to property acquired by gift after September 2, 1958, the basis shall be the basis determined under subsection (a), increased (but not above the fair market value of the property at the time of the gift) by the amount of gift tax paid with respect to the gift.

Section 1.1015-4(a) provides that where a transfer of property is in part a sale and in part a gift, the unadjusted basis of the property in the hands of the transferee is the sum of (1) whichever of the following is the greater: (i) the amount paid by the transferee for the property, or (ii) the transferor's adjusted basis for the property at the time of the transfer, and (2) the amount of increase, if any, in basis authorized by § 1015(d) for gift tax paid.

Based upon the information submitted and representations made, in the present case, the basis of the Trust A assets exceed their fair market value. Accordingly, the basis of the Trust A assets is not increased under § 1015(d) and, for the purpose of determining gain, the basis of the Trust A assets in the hands of the persons receiving the property will be the same as the basis of the Trust A assets at the time of transfer. For the purpose of determining loss, the basis of the Trust A assets is limited to the fair market value of those assets at the time Spouse disclaims her interest.

Except as expressly provided herein, no opinion is expressed or implied concerning the federal tax consequences of any aspect of any transaction or item discussed or referenced in this letter.

The rulings contained in this letter are based upon information and representations submitted by the taxpayer and accompanied by a penalty of perjury statement executed by an appropriate party. While this office has not verified any of the material submitted in support of the request for rulings it is subject to verification on examination.

Pursuant to the Power of Attorney on file with this office, a copy of this letter is being sent your attorney.

This ruling is directed only to the taxpayer(s) requesting it. Section 6110(k)(3) provides that it may not be used or cited as precedent.

Sincerely,

Melissa C. Liquerman

Melissa C. Liquerman
Senior Technician Reviewer, Branch 2
(Passthroughs & Special Industries)

Enclosure

Copy for § 6110 purposes